

Equity Research

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Financials

MGIC Investment Corporation

In-Line 4Q15 EPS Overshadowed by Rate Card Change; MTG Shares Fall Below Book Value

Shares in MGIC Investment Corporation (MTG, Buy, \$12 PT) came under pressure yesterday after management during the conference call following the release of its 4Q15 results announced it would in some cases hike rates during 2016 and, as a consequence, anticipated "modestly" lower business volumes - albeit with a still-growing portfolio - during the year.

MTG

12 month target

\$6.36

\$12.00

BUY

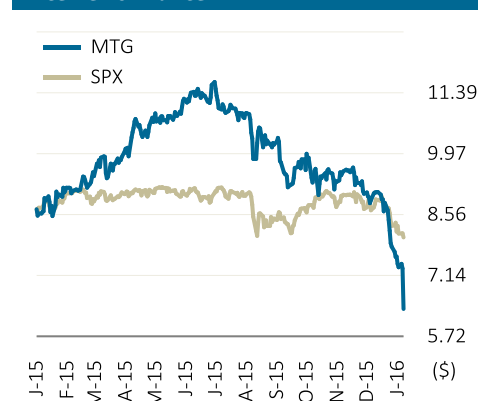
52 week range

\$6.36 - \$11.64

Market Cap (m)

\$2,793

Price Performance



Source: IDC

- ▶ While MTG reported 4Q15 results that were in line with consensus estimates, investors focused on the projected lower volumes. That is understandable, but we believe management's action was prudent and necessary and supportive of the company's margins. Moreover, with MTG shares down by more than 42% over the past six months and the stock trading at 0.97x book value as of YE15, we would argue that the impact of pricing competition within the PMI industry is already baked into the stock price.
- ▶ **We are reiterating our Buy recommendation on MGIC Investment Corporation and price target of \$12** based on 11.5x our 2017E earnings per share of \$1.05. While MTG's insurance volumes are now expected to be lower in 2016 than the prior year, it still stands to benefit from an improving portfolio mix as its legacy book of insurance written in 2005-2008 continues to run off.
- ▶ MTG reported 4Q15 earnings per share of \$0.26, in line with the consensus estimate while beating our estimate of \$0.25.
- ▶ MTG attributed the revision of its premium rate card to higher capital charges imposed on private mortgage insurers. The company will raise rates on lower-FICO homebuyers while lowering them for higher-FICO homebuyers, resulting in an expected decline in new insurance written (NIW) in the single digits in terms of percentage from the \$43bn in
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- ▶ **Valuation:** Our price target of \$12 for MTG is based on 11.5X our 2017E EPS of \$1.05

Estimates

	1Q15 A	2Q15 A	3Q15 A	4Q15 A	FY15 A	1Q16 E	2Q16 E	3Q16 E	4Q16 E	FY16 E	FY17 E
Net Income (Adj.)	95	105	96	99	396	109	119	110	113	451	481
Diluted EPS (Adj.)	0.32	0.28	0.29	0.24	1.13	0.23	0.25	0.23	0.23	0.94	1.05
BVPS (Ex-AOCI)	5.01	5.23	5.43	5.63	5.63	5.86	6.11	6.33	6.57	6.57	7.51

Source: BTIG Research Estimates and Company Documents (\$ in millions, except per share amount)

Please Read: Important disclosures and analyst's certification appear in Appendix

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NIW it posted in 2015. MTG emphasized that the new pricing was expected to result in a return on capital comparable to that generated by the previous rate card.

- ▶ MTG CEO Patrick Sinks added that management expects the company's credit profile to improve in 2016 as new delinquent notices, paid claims and delinquent inventory are all expected to decline.

Income Statement

MGIC - Operating Model	Dec-12	Dec-13	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Dec-16	Dec-17
\$ Millions	2012A	2013A	2014A	1Q15A	2Q15A	3Q15A	4Q15A	2015A	1Q16E	2Q16E	3Q16E	4Q16E	2016E	2017E
Net premiums written	1,017.83	923.48	881.96	234.46	226.78	317.99	241.06	1,020.28	248.70	253.97	259.88	265.17	1,027.71	1,116.77
Increase in unearned premiums	15.34	19.57	(37.59)	(17.17)	(13.27)	(78.75)	(14.87)	(124.06)	(15.18)	(15.50)	(15.86)	(16.18)	(62.72)	(63.21)
Net premiums earned	1,033.17	943.05	844.37	217.29	213.51	239.23	226.19	896.22	233.52	238.47	244.01	248.98	964.99	1,053.56
Investment income	121.64	80.74	87.65	24.12	25.76	25.94	27.93	103.74	28.48	29.05	29.64	30.23	117.40	127.08
Realized investment gains	197.72	6.06	1.50	26.33	0.17	-	1.23	27.72	-	-	-	-	-	-
Total other than temporary losses	(2.31)	(0.33)	(0.14)	-	-	0.64	-	0.64	-	-	-	-	-	-
Proportion of losses recognized in other comprehensive income	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Net impairment losses recognized in earnings	(2.31)	(0.33)	(0.14)	-	-	0.64	-	0.64	-	-	-	-	-	-
Other revenue	28.15	9.91	8.42	2.48	3.70	3.70	2.58	12.46	2.63	2.66	2.68	2.71	10.69	11.01
Total revenues	1,378.36	1,039.44	941.80	270.22	243.13	269.51	257.93	1,040.78	264.63	270.19	276.33	281.92	1,093.08	1,191.65
Losses incurred	2,067.25	838.73	496.08	81.79	90.24	76.46	95.07	343.55	74.90	76.49	78.27	79.86	309.52	324.93
Change in premium deficiency reserve	(61.04)	(25.32)	(24.71)	(6.42)	(17.33)	-	-	(23.75)	(6.48)	(17.51)	-	-	(23.99)	(24.23)
Amortization of deferred policy acquisition costs	7.45	10.64	7.62	-	-	-	-	-	-	-	-	-	-	-
Underwriting and operating expenses	194.00	181.88	138.44	41.03	37.88	48.44	37.02	164.37	37.12	37.21	37.30	37.39	149.02	150.52
Interest expense	99.34	79.66	69.65	17.36	17.37	17.36	16.84	68.93	16.84	16.84	16.84	16.84	67.34	67.34
Total losses and expenses	2,307.01	1,085.59	687.07	133.75	128.15	142.26	148.92	553.09	122.37	113.03	132.41	134.09	501.90	518.56
Income (loss) before income taxes	(928.64)	(46.15)	254.72	136.46	114.98	127.25	109.00	487.69	142.26	157.16	143.93	147.83	591.18	673.09
Provision for income taxes	(1.57)	3.70	2.77	3.39	1.32	(695.60)	6.58	(684.31)	46.95	51.86	47.50	48.78	195.09	222.12
Net income (loss)	(927.08)	(49.85)	251.95	133.08	113.65	822.85	102.42	1,172.00	95.32	105.30	96.43	99.05	396.09	450.97
Adjusted EPS	(\$4.59)	(\$0.16)	\$0.61	\$0.32	\$0.28	\$0.29	\$0.24	\$1.13	\$0.23	\$0.25	\$0.23	\$0.23	\$0.94	\$1.05
Diluted shares outstanding	201.89	311.75	413.55	468.14	439.15	468.15	467.95	460.85	468.42	468.89	469.35	469.82	469.12	471.00
Tax rate	0.2%	-8.0%	1.1%	2.5%	1.1%	-546.7%	5.0%	-140.3%	33.0%	33.0%	33.0%	33.0%	33.0%	33.0%
Book Value per diluted share	0.97	2.20	2.36	2.53	2.82	4.59	4.81	4.81	5.01	5.23	5.43	5.63	5.63	6.57
Average primary IIF	166,537.5	159,425.0	160,350.0	165,500.0	167,450.0	170,700.0	173,550.0	169,300.0	176,240.0	179,979.9	184,161.7	187,912.0	182,073.4	196,926.8
Total primary NIW	24,100.0	29,800.0	33,400.0	9,000.0	11,800.0	12,400.0	9,800.0	43,000.0	8,820.0	9,440.0	9,920.0	8,820.0	37,000.0	38,480.0
Average premium rate	0.62%	0.59%	0.53%	0.53%	0.51%	0.56%	0.52%	0.53%	0.53%	0.53%	0.53%	0.53%	0.53%	0.54%

Source: BTIG Research Estimates and Company Documents

Appendix: Analyst Certification and Other Important Disclosures

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I, Mark Palmer, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

I, Giuliano Bologna, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

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Company Valuation and Risk Disclosures

MGIC Investment Corporation (MTG, Buy)

Valuation: Our price target of \$12 for MTG is based on 11.5X our 2017E EPS of \$1.05

Risks: The primary risks to our thesis include: Competition with other PMIs could result in lower revenues and/or lower premium yields. Additional moves by the FHA to make its mortgage insurance offering more competitive could adversely impact demand for MTG's product. A downturn in the U.S. economy could result in higher delinquencies and higher losses on MTG's existing portfolio.

Other Disclosures

Additional Information Available Upon Request

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